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Solid Wood Products

Forest Industry Profitability Declines in 2001 2002

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Report Highlights:

After two years of encouraging levels of profitability, the B.C. forest industry performed at only slightly above a breakeven level in 2001, according to a PricewaterhouseCoopers report. A C\$200 million profit in 2001 represents a significant decline over the industry's final net earnings for 2000, which came in at C\$1.5 billion. The B.C. industry had total sales of C\$18 billion last year, down slightly from C\$19.3 billion in 2000. Return on capital employed fell to 3.0% after coming in at a relatively high 11.4% in 2000.

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FOREST INDUSTRY PROFITABILITY DECLINES SIGNIFICANTLY IN 2001

According to a report by PricewaterhouseCoopers, after two years of encouraging levels of profitability, the B.C. forest industry performed at only slightly above a breakeven level in 2001. A \$200 million profit in 2001 represents a significant decline over the industry's final net earnings for 2000, which came in at \$1.5 billion (all figures in C\$ except where noted).

The B.C. industry had total sales of \$18 billion last year, down slightly from \$19.3 billion in 2000. Return on capital employed (ROCE) fell to 3.0 per cent after coming in at a relatively high 11.4 per cent in 2000. Low prices last year for both lumber and pulp were major contributing factors, notes Craig Campbell, one of the leaders in PricewaterhouseCoopers' Global Forest and Paper Practice. He adds, however, that various B.C.-specific considerations further impacted industry performance.

"B.C.'s biggest challenge last year was the substantial duties that were imposed on lumber shipments to the U.S. as a result of the softwood lumber dispute," says Campbell. The duties apply to Eastern Canadian forest companies as well, but Campbell notes that those producers are typically less heavily focused on lumber than B.C. companies, and more diversified into pulp and paper.

"The potential impact of the duties on the Canadian industry amounts to over a billion dollars annually," Campbell says, "and the B.C. industry could end up bearing half of that additional cost. This is an extremely serious trade issue with the potential to cripple both the B.C. economy and Canada's largest export industry."

The other major factor impacting the performance of the B.C. industry, Campbell notes, is the cumulative effect of various market and structural challenges facing coastal producers. Demand remained weak during 2001 in the Japanese market, which has been a mainstay for coastal forest companies. High operating costs, manufacturing over-capacity and low levels of capital upgrading on the coast also constitute an increasing drag on the overall performance of the B.C. industry and the provincial economy.

Pulp prices averaged \$548 (U.S.) per metric tonne during 2001. This was a much larger decline than expected from the 2000 average of \$685, and approached historic lows. Lumber prices were somewhat stronger but still low, averaging \$257 (U.S.) per thousand board feet during 2001. Lumber prices also displayed particularly high volatility over the year, ranging from \$180 to \$350 (U.S.), in part due to supplier and purchaser responses to developments in the softwood dispute.

In addition to its detailed analysis of the B.C. industry, PricewaterhouseCoopers will also release today comparative assessments based on the performance of the largest public forest and paper companies based in B.C., Eastern Canada, the U.S. and globally. Net earnings and return on capital employed declined in 2001 in each of the samples. However, the industry remained moderately profitable with ROCE in the 3-4 percent range.

"2002 is going to be another challenging year for the forest and paper industry," says Campbell. "Prices for both pulp and lumber may improve marginally, but the economic outlook suggests

there will not be significant recovery until the end of the year at the earliest. Newsprint prices are also expected to remain low until year end."

"Looking across the global industry landscape, however, we do see some individual companies that are bucking the trend towards lower returns," Campbell says. "Our research indicates that the extent to which a company is customer-focused is a key distinguishing factor. Those companies that are more closely integrated with their customers are typically the ones that are posting relatively strong performance, even in this challenging environment."

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